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ABSTRACT

Although school funding structures are similar in many ways across the states, no two states have school finance systems that are precisely the same. School finance systems which are used to achieve multiple objectives, must consider characteristics of numerous school districts, distribute large amounts of money, and have developed incrementally over long periods. Given the multiple goals that every state's school finance system is trying to achieve and the large number of districts such systems must consider, it is not unexpected that they would be somewhat complicated. In most states, there are few legislators, legislative staff, educators, academics, and the general public who are familiar with the intricacies of school finance. This document functions as a guide to understanding the complexities of school finance systems, in an effort to encourage more policy makers to become familiar with and to take an interest in school finance. It contains a quick lesson in the development of school finance systems, a brief overview of the goals on school finance systems, a short discussion of the relationship between the structure of school finance systems and school finance litigation, and an organized description of the various components of school finance systems. Examples use simple arithmetic and describe the various calculations undertaken. A glossary is appended. (LAP)

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SCHOOL FINANCE: A PRIMER

A PRACTICAL GUIDE TO THE STRUCTURAL COMPONENTS OF, ALTERNATIVE APPROACHES TO, AND POLICY QUESTIONS ABOUT STATE SCHOOL FINANCE SYSTEMS

by

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Introduction

One reason why state policy makers should be interested in their school finance systems is because so much money either passes through them directly or is controlled indirectly by them.

Collectively, the states provide about 50% of the over $200 billion in revenue raised to operate the nation's public schools. On average, state aid to public schools consumes about 28% of state own-source revenues. Given the magnitude of state investment in public schools and the fact that most states have numerous school districts, which cover the entire state and compete vigorously for their share of state aid, it is not surprising that school finance systems are so "political."

A state's school finance system is a series of procedures, formulas, and mechanisms defined in the constitution, in statute and in regulation to:

- Allocate state support to the state's numerous school districts
- Reimburse school districts for particular expenditures they incur
- Control the spending levels and tax rates of school districts
- Regulate how districts spend the revenues they obtain and
- Provide incentives for school districts to behave in particular ways.

While each state approaches these tasks uniquely, whatever approach is used will have a significant impact on every school district. School districts with diverse characteristics are affected in different ways by a state's school finance system. Districts with various demographic characteristics, needs and fiscal capacities are likely to view a state's school finance system differently depending on the structure of the system, the amount of money it provides and the extent to which it controls school districts.

School finance systems are designed to achieve several objectives, some of which conflict with one another. The broad objectives of most school finance systems are:

- To assure that every district can obtain a level of revenue considered to be "adequate" or at least "basic"
- Promote equity across districts in terms of revenues and tax effort by providing more aid to districts with relatively high need, relatively low wealth, relatively high tax effort or some combination of these characteristics
- Reimburse districts for a portion of the costs associated with the provision of high-cost programs (such as special education) and non-instructional programs (such as transportation) and
- Provide districts with the ability to generate supplemental revenue, sometimes within strict limits that control the absolute level of spending, annual increases in spending or changes in property tax revenue or tax rates.

In most states, there are few people among legislators, legislative staff, educators, academics and the general public who are familiar with the intricacies of school finance. To many, a school finance formula is as confusing as Russia was to Winston Churchill in 1939 when he said that country's behavior was "a riddle wrapped in a mystery inside an enigma." **School finance systems are complicated for a variety of reasons:** (1) they are used to achieve multiple objectives; (2) they consider characteristics of numerous school districts; (3) they distribute large amounts of money; and (4) they have developed incrementally over long periods of time, often adding new features on top of old ones.

Complexity may obscure the purposes for which a school finance system is created, and it may deter all but the most zealous policy maker who really wants to know what the system is all about. This primer is designed to be helpful in explaining the complexity as simply as possible so as to encourage more policy makers to become familiar with and to take an interest in school finance.

Although school funding structures are similar in many ways across the states, no two states have school finance systems that are precisely the same, no matter how similar on the surface. Because of the number of components and the countless possibilities for combining them, the different characteristics of the states and the historical development of the systems, each is unique. For more information about the particular components of each state's school finance system, see *School Finance at a Glance* (published by ECS in April 1990) and *Public School Finance Programs of the United States and Canada, 1986-87* (published by the American Education Finance Association and Virginia Polytechnic Institute and State University in 1988). Both ECS and AEFA will be updating these documents in 1992.

To benefit from this primer, one does not need to be a mathematical genius, be familiar with equity statistics and/or know how to read computer printouts. The primer provides a quick lesson in the development of school finance systems, a brief overview of the goals of school finance systems, a short discussion of the relationship between the structure of school finance systems and school finance litigation, and an organized description of the various components of school finance systems. Examples use simple arithmetic and describe the various calculations undertaken. **There is no single best school finance system, and there are myriad ways to build rational school finance systems.**

I. The Development of School Finance Systems

Until the early part of the 20th century, state aid was typically allotted on the basis of the number of schools or teachers in each district, providing a flat amount per school or teacher that was the same across all districts. It became apparent to some analysts that the methods used to distribute state support were inappropriate for a variety of reasons. *First*, the basis of distributing the flat grant was considered improper because it did not reflect the real needs of school districts. *Second*, the distribution of a small amount of state aid through a flat grant did little to assure that all districts could provide adequate education services. *Third*, researchers noted that disparities existed in the revenues of school districts and in the property tax rates needed to generate those revenues.

Foundation Program

In the 1920s and 1930s, states began to implement a new approach to distributing state aid for public schools — the "foundation program." **Under the foundation approach (discussed in more detail on page 7), the state sets a level of revenue that every school district can generate, provided that it makes a specified tax effort.** When first implemented, the foundation program was typically combined with an existing flat-grant program, assuring that every district would receive some state support even if it did not qualify under the foundation program. There are numerous policy questions that must be addressed to construct a foundation program, resulting in structural differences across the states. Nonetheless, the foundation program remains the most popular method for allocating state aid to school districts and it exists in one form or another, at one level or another, in 39 states.

One of the most important impacts of the use of the foundation program in the 20th century was the expansion of state aid as a proportion of school district revenue. In 1919-20, state aid provided 16.5% of all school revenue. By 1939-40, state aid rose to 30.3% of all school revenue, primarily as a result of the expanded use of foundation programs in the states. It was not until the mid-1970s, in response to the growth in school finance litigation, that state aid provided in excess of 40% of school revenue. Today, state aid provides, on average, nearly 50% of the revenue for schools.

Reward-for-Effort

In the 1970s, a new kind of state aid approach was developed to respond to one of the major shortcomings of the foundation approach. **The new approach, the "reward-for-effort" method, moved away from the use of state-determined revenue levels and specified tax rates in order to provide flexibility to school districts in revenue and tax rate decisions.** The reward-for-effort approach (discussed on page 11) can be formulated in several different ways, including "guaranteed tax base," "guaranteed yield" and "power equalizing." The guaranteed tax base, for example, assures that all school districts can behave "as if" they had a state specified tax-base level. Using this approach, districts may determine their own spending levels and tax

rates rather than being constrained by the specific levels identified in a foundation program.

In the 1970s, states also took steps to improve the sensitivity of their aid allocation mechanisms to the various needs of school districts. As high-cost educational programs expanded for special pupil populations (for example, handicapped pupils, pupils participating in vocational programs, pupils without English proficiency and so on), states developed "categorical" or "block grant" programs to provide supplementary resources to school districts, particularly those with high concentrations of pupils with special needs. Under most categorical programs, states pay a specific amount or a fixed proportion of the excess cost of providing special services or programs and require districts to spend such revenue for those programs; the block grant approach includes a rational way to distribute funds relative to needs but gives school districts greater authority to determine how such funds are spent.

Categorical Programs

The problem with most categorical programs is that, while they are sensitive to the varying needs of school districts, they may not be sensitive to the varying wealth of school districts (unless the state pays all, or almost all, of the cost). If two districts with different wealth each receive 60% of the excess cost of serving handicapped pupils from the state, they both must generate the other 40% of the excess cost; this may place a higher tax burden on the district with lower property wealth. **One way to combine sensitivity to wealth with sensitivity to need is through the use of pupil "weights."**

Pupil Weight Systems

A pupil weight is nothing more than the ratio of the cost of serving a pupil with a particular set of special needs. Thus, a weight of 1.50 attached to a pupil indicates that it costs 50% more to serve that pupil than a pupil with no special needs. Weights can be applied to particular pupils or to every student in districts with characteristics that affect the cost of providing education services to all pupils (such as the size of the districts, declining enrollment, regional cost-of-education differences, etc.).

Today, it is not unusual for states to combine the various approaches for distributing state aid that have been developed during the evolution of school finance systems. A state might blend a foundation program, in order to assure a basic level of support and a minimum tax rate, with a reward-for-effort approach, in order to provide flexibility for districts to raise revenue above the foundation program. A state then can assure a minimum level of state aid to every district and use categorical programs or pupil weights to consider the special needs of different school districts.

II. School Finance Litigation

Many state policy makers are concerned about the resurgence in school finance litigation that has been stimulated by the recent success of plaintiffs in **Montana** (1989), **Kentucky** (1989), **Texas** (1989 and 1991) and **New Jersey** (1990 and 1991). Today, it is difficult to keep track of all the states involved in school finance litigation or where they are in the process—publicity by potential plaintiffs about the possibility of filing a case, actual filing of a case, trial, lower court decision, appeal or decision of a state supreme court. The process may take years to complete. For further information about the status of state litigation, contact Mary Fulton at the Education Commission of the States.

Development of School Finance Litigation

School finance litigation was initiated in the 1960s when programs for special pupil populations were beginning to proliferate. **The issue in the earliest cases was that state aid, primarily distributed through flat grants and foundation programs, was not sensitive to the varying needs of pupils and school districts.** These cases were filed in federal court and did not make progress because, at the time, it proved impossible to identify special needs and to quantify the costs of serving pupils and districts with special needs.

Following the failure of these cases, a new theory was developed based on the variation in the per-pupil spending of school districts and the relationship between the wealth and spending. Under this theory, such disparities and relationships were viewed as violating the equal protection clause of the U.S. Constitution, particularly if education were considered to be a "fundamental right" (like the right to vote) guaranteed by the Constitution and district wealth a "suspect classification" (like race) under the Constitution.

In *Serrano*, plaintiffs prevailed using this theory in a federal court in California. The school finance system was found not to be "fiscally neutral" — that is, the resources available to educate children were a function of school district wealth, not the wealth of the state as a whole. The approach ultimately failed, however, at the federal level. In a Texas case (*Rodriguez*), the U.S. Supreme Court ruled that education was not a fundamental right, district wealth was not a suspect classification, and the Texas system of school finance was rational, passing the standard used by the court when judicial "strict scrutiny" is not required.

Since the mid-1970s, school finance cases have been filed in state courts rather than in federal, with plaintiffs claiming that disparities in spending, the relationship between wealth and spending and a variety of other conditions violated state constitutions' equal protection clauses and education clauses (many of which require that education be provide in a "thorough," "efficient," "basic," "ample," or "uniform" manner).

Between 1970 and 1983, school finance systems were found unconstitutional in **Arkansas, California, Connecticut, New Jersey, Washington, West Virginia** and **Wyoming**, while being upheld in numerous other states.

Two examples from the recent spate of decisions illustrate the relationship between the structure of school finance systems and decisions about their constitutionality.

In **Montana**, which used a foundation program as the basis for distributing state support, plaintiffs argued that the foundation level assured by the state was low relative to district actual spending. The majority of funds raised by districts came from outside any formula that considered districts' relative wealth or tax effort and resulted in a large spending variation. This strengthened the relationship between wealth and spending in violation of the state constitution's education clause, which requires the provision of "equal educational opportunity."

School Finance Litigation

New Jersey used a reward-for-effort approach to assure that education was provided in a "thorough-and-efficient" manner. This system was developed in 1975 after a previous system was found unconstitutional in 1973. Plaintiffs argued that some districts, particularly a set of urban districts, were unable to take advantage of the opportunities provided by the system because they could not increase their property tax rates. An increase would have generated more local and state funds. Plaintiffs also successfully claimed that the minimum aid provided to wealthy school districts was inappropriate and that full state payment of pension and social security costs created inequities.

Misconceptions about the role of the courts in school finance have emerged over the years. **The role of a court tends to be one of identifying standards by which to determine whether the effects of a school finance system meet the requirements of constitutional language.**

- Courts typically identify the legislature as the body that must revise the system and are usually circumspect about making recommendations.
- Courts have not required the elimination of property taxes to fund schools.
- Courts have not required legislatures to raise existing taxes or to impose new taxes to provide enough money to fund a revised school finance system although they may require that the new system be fully funded. As a result of court intervention, state aid usually increases as a proportion of all school revenue. Local control over how much revenue can be generated (but not over how funds may be spent) may be diminished.

School finance litigation does appear to be changing. **While plaintiffs continue to emphasize disparities in relationships among wealth, tax rates and revenues of school districts, they also are raising questions about the adequacy of resources for education (particularly in light of increased state mandates).** Plaintiffs are asking what education dollars are providing, not just the amount provided. They are questioning the treatment of special groups (particularly pupils from low-income families) and the impact of the school finance

system on particular kinds of school districts (i.e., small, rural or urban districts or districts experiencing rapid growth). They are addressing the funding of school facilities, the approaches taken by states to reduce state aid when less money is available than is required, and the role of property assessment practices and state tax policies (i.e., differential assessment, tax limitations and tax relief strategies).

III. Basic School Finance System Structures

The three basic mechanisms used to distribute state aid for education —the flat grant, the foundation program and the reward-for-effort approach — can be structured individually or combined in numerous ways. This section describes some of the structural choices available to policy makers as they build a school finance system. Because the flat grant is relatively simple and not widely used, it is not discussed separately.

The Foundation Program

The basic structure of the foundation program is simple: the state sets a foundation level and a local tax effort and then pays the difference between the amount of revenue generated at that effort and the amount guaranteed as a foundation.

For example, if the foundation level were $1,000 per pupil, the required local effort were 30 mills of property tax (a mill is .01 of a cent or $.001), and a school district had $20,000 of property wealth per pupil, then the district would raise $600 per pupil ($20,000 times .030) and the state would provide $400 per pupil in aid. If a second district had $10,000 of property wealth per pupil and levied the 30-mill property tax, it would raise $300 per pupil ($10,000 times .030) and the state would provide $700 per pupil in aid.

This approach raises two fundamental questions:

- What happens if a district chooses not to make the tax effort specified by the state?
- What happens if a district can generate more than the foundation level at the specified tax effort?

There are several possible ways a state can respond to each of these questions. In the case of the first question, the state has three choices:

1. **The state can distribute aid to districts *as if* they made the specified tax effort, even if it did not.** However, if the district had a lower tax effort, it would generate fewer funds for education. Using the original example, if the district with $20,000 of property wealth per pupil levied a 20-mill property tax (instead of the specified 30 mills), the state would still pay $400 per pupil (as if the district taxed itself at 30 mills), but the district would only generate $400 per pupil. This results in less district revenue ($800 per pupil rather than $1,000) and a disparity in tax effort across school districts.

2. **The state could reduce aid in proportion to the lower tax effort made by the district.** If the district makes a 20-mill effort, two-thirds of that specified, then state aid would be two-thirds of the amount that would have been provided. For example, using a tax rate only two-thirds of that specified, the district with $20,000 of property wealth per student would receive only $267 per pupil (two-thirds of $400). Local revenue also would be reduced from $600 ($20,000 times .030) to $400 ($20,000 times .020) and total revenue would be $667 ($267 from the state and $400 from property taxes) rather than $1,000. In

this case, the state has treated districts "equitably" (because the amount of revenue generated will be in proportion to tax effort), but the result is lower revenues for public schools.

3. **The state could specify local contribution as a dollar amount, equivalent to the amount that would be raised at the specified tax rate, but allow the district to use revenue from other sources.** In this case, the district might choose to lower its tax effort from the specified 30 mills to 20 mills, but make up the loss from other sources (other local taxes, fund balances, or some other source excluding federal revenue). The result is that the amount of revenue available is equal to the foundation level, although tax effort is not the same across all districts.

In the question of what happens if a district can generate more than the foundation level at the specified tax effort, the state has two choices:

1. **Allow the district either to keep the excess amount it generates or reduce its tax rate so it only produces the foundation level.** For example, using the example above, if a district had $40,000 of property wealth per pupil, it would raise $1,200 per pupil at the specified 30-mill property tax effort. The state would provide no state aid and the district would either keep the extra $200 per pupil or reduce its property tax rate to 25 mills ($40,000 times .025 will produce $1,000 per pupil, the foundation level). In this case, the state is permitting the possibility of revenue or tax effort disparities across districts, and its decision to do so will probably be influenced by how many districts and how many pupils are involved.

2. **Require all districts to make the specified level of effort and collect all or a portion of the excess revenue generated.** For example, if a district had $40,000 of property wealth and generated $1,200 per pupil at the specified (and required) tax effort, the state could "recapture" all or a portion of the $200 generated above the $1,000 foundation level. This approach assures greater equity in revenue and tax effort across school districts but may be difficult to implement.

There are two other broad questions that must be addressed in building a foundation program:

- How will the foundation level be determined?
- What will the level of local contribution be?

There are four ways to determine the foundation level

1. Calculate the level on the basis of available state revenue.

Given that policy makers know how much money they have to spend, how much revenue will be produced from local sources and how many pupils or classroom units need to be funded, it is relatively easy to set a foundation level.

For example, assume there are 500,000 pupils in a state, local revenue to be included in the foundation program is $400 million and the state has $600 million available for general education support. The foundation level could be $2,000 per pupil ($400 million + $600 million = $1 billion — divided by 500,000 pupils). In fact, this kind of approach is typical of how many states set the foundation level.

One problem with this approach is that it may not provide much stability over time. If, for example, state revenues deteriorate in a year or two and local revenues do not make up the loss (because property values are falling or not increasing as rapidly as inflation or because state policy makers are reluctant to raise local tax rates), the foundation level may decline or not keep up with inflation. This is the most common problem with foundation programs — they are designed to reflect the actual spending of school districts in a given year. Because of the volatility of state and local revenues, however, they do not increase as rapidly as inflation (or increases in education expenditures), resulting in a situation where the foundation level is relatively low compared to the average expenditures of school districts.

Building in an annual adjustment to reflect cost increases caused by inflation will deal with this problem to the extent that education costs increase in step with inflation. This approach should maintain a reasonable foundation level provided that state and local revenues are sufficient to foot the statewide cost of the program. Even with this kind of adjustment, this first approach to setting the foundation level protects the state treasury but provides little solace to educators.

2. Let education expenditures determine the foundation level.

The foundation level is the statewide mean or some other indicator of the average spending of school districts, such as the 50th percentile (median) that reflects the spending of all districts in the state. By defining what expenditures will be used in the calculation, the state can control this to some extent. The state can also change the indicator from year to year — using the 70th percentile in one year and the 65th percentile in the next year, but essentially the foundation level is determined by the spending of school districts. **This approach may put the state in an untenable position when revenues decline, although educators will probably support its use, particularly when the definition of expenditures is loose.**

3. Create an "input" system determined by a specific set of education resources.

In this case, the state determines the cost of providing an array of resources, primarily in terms of numbers and types of personnel at specified salary levels. For example, the state might determine that there should be one teacher (at $26,000) for each 20 pupils, one counselor (at $24,000) for each 300 pupils, a principal (at $35,000) for each school and $620 per pupil for plant maintenance and operation. In a district with 3,000 pupils in eight schools, the total cost of such a program would be $6 million or $2,000 per pupil. **This approach can be become extremely complicated as the level of specificity of the resources increases and the need for supportive data expands.** Such a system also requires a statewide salary schedule of some sort.

Determining the Foundation Level

The advantage of such a system is that it can be linked to state resource requirements. For example, when state policy makers determine that the ratio of pupils to teachers should be lower in particular grades or that specialists must be provided, those requirements can be added directly into the foundation level.

4. Develop a cost "model."

Given the problems of keeping foundation levels current and the growing list of state-initiated school district requirements, many of which are not specified in resources terms (for example, the state may require the district to provide a particular kind of service without designating how that service is to be provided), a fourth approach is emerging for determining the foundation level.

This approach is based on an analysis of how much it actually costs to provide services. A cost "model" is one method that does not require specific knowledge about how the services are provided. It requires identification of the way services are provided, at least for purposes of calculation, or an evaluation of the costs incurred by districts that provide the required services. This approach has the advantage of attempting to link costs to state service requirements while avoiding state prescriptions about service delivery. **One of the difficulties of this approach is making it sensitive to different characteristics of school districts, such as size, that may affect the cost of providing a specific set of services.**

A variety of options are available to states in determining what the level of local contribution will be. In a few states, no local contribution to the foundation program is expected; that is, the state determines the foundation level and pays the full cost of the program. However, most states with foundation programs require that districts tax property at a specific rate. The revenues produced act as a deduction against the state's obligation to pay the full cost of the foundation program. In some states, the level of property tax effort has been kept low by either setting the tax rate at a low level and keeping it constant over time or by determining a total statewide contribution expected from property taxes and keeping that amount constant over time, despite increases in property value.

Most states that expect districts to obtain revenue from property taxes require that property assessment be similar, if not precisely equal, across school districts. It is not unusual for states to "equalize" property values, modifying the figures provided by local assessors so that assessment to market value is consistent across school districts. As mentioned above, in some states, the amount of property tax revenues to be provided to the foundation program is specified, but local districts may obtain such revenue from other sources.

In some states, the amount of local tax revenue to be provided in support of the foundation program may be based on tax bases other than property even though all local funds actually raised must come from property taxes. This is the case in states that measure the fiscal capacity of school districts through a combination of factors, such as property wealth, income, sales tax revenues and so on. In some cases, an adjustment to expected property tax revenue may be made in recognition of the fact that tax collections are less than 100%.

Determining Local Contribution

It is not unusual to count other revenue as deductible against foundation program costs. For example, in some states a portion of locally collected fines, license fees or other revenue is considered to be local revenue in addition to property taxes. Some states may count a portion of county or intermediate district revenue as local revenue. In a few states, where a portion of a statewide tax is rebated to school districts, a portion of the amount rebated may count as a local contribution toward the foundation program.

Some states count excess fund balances of school districts as local revenue. That is, if fund balances are limited (typically as a percentage of expenditure, which may vary by school district enrollment level), the excess above the amount allowed is assumed to be available to pay for foundation program costs. Finally, some states may count a portion of unrestricted federal funds (impact aid, forest reserve, Taylor grazing or Johnson-O'Malley funds) as local revenue deductible against foundation program costs (a state may not choose to deduct impact aid unless it passes an "equity test" required by the federal government).

Although any source of local funds reduces the cost to the state of operating a foundation program, it is important to examine such revenues carefully. If a source of local revenue is not counted (or a portion of the revenue is not counted), then such revenue becomes available to districts for their use. This can contribute to disequalization (that is, wealthy districts obtain more than others). On the other hand, if a source of local revenue is dedicated to particular functions outside the foundation program (such as transportation fees, tuition receipts or revenue from auxiliary enterprises), it may be inappropriate to count such revenue as a deductible against foundation program costs.

The Reward-for-Effort Approach

In many ways, the reward-for-effort approach has characteristics similar to the foundation program. In fact, the foundation program can be viewed as a kind of reward-for-effort approach with the effort held constant. **The difference between a foundation program and a reward-for-effort system lies in the flexibility given to school districts under the reward-for-effort approach.** While the flexibility may be a boon to school districts (sometimes flexibility is not valued by districts because it means that tax decisions must be made locally either by the school board or the voters), it can cause problems for states because of the unpredictability of school district tax behavior. The only way a state can predict the cost of a reward-for-effort system accurately is to know the tax rates of school districts in advance. Without such information, it is only possible to estimate the costs of such programs.

The three kinds of reward-for-effort systems are the guaranteed tax base, guaranteed yield and "power-equalized" system.

1. **Guaranteed Tax Base — A system that specifies a level of tax base which all districts may assume to have in setting school tax rates.** For example, a state may have 300 school districts, which range in wealth from $10,000 to $200,000 in per-pupil property wealth. The state may set the guaranteed tax base at $150,000 of property wealth per pupil, assuring all districts at or below that level that a mill of tax effort will produce as much revenue as a mill applied on $150,000 of property wealth. The state makes up the difference between what the district actually produces and the amount guaranteed. Districts with more than $150,000 of property wealth receive no state aid and keep the excess revenue they produce (a mill of tax on $200,000 of wealth produces $200 per pupil, $50 more than a mill would produce on $150,000 of property wealth.)

2. **Guaranteed Yield — A system that specifies an amount of revenue that can be obtained per unit of tax effort.** For example, if the state guaranteed a yield of $150 per pupil per mill of tax effort, a district with $100,000 of property wealth would generate $100 per pupil per mill from its tax base, and the state would provide $50 per pupil per mill in aid. Districts with less than $150,000 of property wealth per pupil would receive some amount of state aid, while districts with more than $150,000 of property wealth per pupil would receive no state aid and would be able to generate more than the state guarantee of $150 per pupil per mill.

3. **Power Equalization — A system that operates in the same way as the guaranteed yield approach with the assumption of recapture.** That is, for districts with wealth so high that they have the ability to exceed the guaranteed yield, all excess funds are collected by the state to ensure maximum equity.

Policy makers should ask three basic questions about the design of a reward-for-effort system:

- How will the guarantee level be determined?
- Will the system provide multiple guarantee levels?
- Will minimum or maximum tax effort be specified?

How will the guarantee level be determined?

As with the foundation program, there are a variety of ways to determine the level of the guarantee assured by the state. Selecting the guarantee level has important implications for the amount of state aid that will be required to support the system.

A reward-for-effort system establishes a guarantee based on school district wealth, not spending levels.

Determining Guarantee Level

Essentially, the state must decide whether the guarantee will be set at the level of the highest wealth district in the state (in which case all districts except the wealthiest receive state aid, but at great cost to the state) or at some lower level. For example, under a guaranteed tax base approach, if a state has school districts that range in wealth

from $10,000 to $200,000 per pupil, the state could set the guaranteed tax base at $200,000. In this case, a district with $100,000 per pupil of wealth would receive an amount of state aid equal to the amount of local revenue raised at whatever tax rate the district selects (if the district selected a tax rate of 20 mills, the state would guarantee that it could raise $4,000 per pupil ($200,000 x .020), of which $2,000 would be derived from local property taxes ($100,000 x .020) and the remaining $2,000 per pupil would be provided by the state. This would result in a "matching rate" of one state dollar provided for each local dollar raised. A district with $10,000 of per-pupil wealth also would be guaranteed that it could generate $4,000 per pupil if it imposed a tax rate of 20 mills. However, because local revenue would only be $200 per pupil ($10,000 x .020), state aid would be $3,800 per pupil (a matching rate of 19 to one).

An alternative to the approach of choosing the wealthiest district in the state is to use the statewide average wealth.

If the statewide average wealth were $120,000, and the guaranteed tax base were set at that level, all districts with per-pupil wealth below $120,000 would and none of the districts above that level would. All districts would be guaranteed that they could generate $2,400 per pupil if they levied a property tax of 20 mills. The district with $100,000 of property wealth per pupil would raise $2,000 per pupil with a 20-mill tax rate; state aid would be $400 per pupil (a matching rate of one state dollar for each five local dollars). For the district with $10,000 in per pupil property wealth, $200 per pupil would be generated if the property tax rate were 20 mills. State aid would be $2,200 per pupil (a matching rate of 11 to one).

Using the statewide average as the guarantee, all districts above the average would generate more revenue at the property tax effort of districts with wealth below average. For example, a district with $150,000 of property wealth would raise $3,000 per pupil using a 20-mill property tax effort, $600 more than the amount guaranteed to districts with below-average wealth. Unless this approach were "power equalized" (requiring the use of recapture, as described above), there could be disparities in the revenue of school districts and wealthy districts would have more revenues for the same tax rates.

Determining Guarantee Level

A third approach to setting the guarantee is to choose a level of wealth above the average but not the highest in the state. For example, the state might select the 75th percentile (based on pupil enrollment) of wealth. This would assure that 75% of the state's pupils are enrolled in districts that would benefit from the system. Again, assuming that recapture is not being used, the higher the level of guarantee, the greater the number of pupils enrolled in districts receiving state aid, the lower the level of disparity in revenues across districts with the same tax effort, and the more costly the system would be to the state.

One way to use expenditures to determine a guarantee level in a reward-for-effort system is for the state to choose a particular spending level (using any of the approaches described in the discussion of foundation programs), choose a level of tax effort and com-

bine the two to determine the level of guaranteed wealth. For example, if the average spending in a state were $3,000 per pupil and the average tax rate were 20 mills, the state could set the guaranteed tax base at $150,000 of wealth per pupil ($3,000 divided by .020). A guaranteed tax base of $150,000 is the same as a guaranteed yield of $150 per pupil per mill of tax effort (the amount a tax of one mill will produce on wealth of $150,000).

Will multiple guarantee levels be used?

Multiple levels are used to reduce the incentive provided by a reward-for-effort system for districts to increase their tax rates (and their revenue levels) as well as to control the cost of the system to the state. For example, the state could set a guaranteed tax base of $150,000 for the first 20 mills of property tax effort and a guaranteed tax base of $100,000 for every mill of property tax effort over 20 mills. If a district had wealth of $80,000 and a property tax rate of 30 mills, it would be guaranteed that it could generate $4,000 per pupil in revenue ($150,000 times .020 plus $100,000 times .010). The district would raise a total of $2,400 per pupil ($1,600 on the first 20 mills [$80,000 times .020] and $800 on the next 10 mills [$80,000 times .010]). State aid would be $1,400 per pupil for the first 20 mills ($3,000 minus $1,600) and $200 per pupil on the next 10 mills ($1,000 minus $800).

Reward-for-Effort Approach

Districts with less than $100,000 of property wealth per pupil would be eligible for state aid under both levels of the system (provided their tax rates exceeded 20 mills); districts with between $100,000 and $150,000 of property wealth per pupil would be eligible for state aid under the first level but not the second; districts with more than $150,000 of property wealth per pupil would not be eligible for any state aid. While the use of multiple levels complicates a reward-for-effort system, it also gives greater flexibility to a state and targets state aid toward districts making lower tax effort and raising lower amounts of revenue.

Should the state control the tax rates of school districts?

If the state did not control tax rates (at least for the purposes of allocating state aid), some districts might select very low tax rates and produce low levels of revenue. Other districts might select very high tax rates (which, if they had relatively low wealth, could require large amounts of state aid). This situation also could result in a large revenue disparity if low-wealth districts chose low tax rates and high-wealth districts chose high tax rates.

To control this situation, the state can set minimum and maximum tax effort requirements. In effect, the use of a minimum tax effort in a reward-for-effort system creates a foundation program; therefore, all of the policy issues raised about setting foundation levels need to be addressed. The state also needs to be cautious about setting a maximum tax effort, particularly if the maximum is low relative to the average tax rates of school districts.

Tiered Funding Systems

It is possible to combine a reward-for-effort system with a foundation program, creating what are sometimes referred to as "tiered" systems — school finance systems with multiple components. A flat grant, unmatched local levy or categorical program could also be viewed as a "tier." **The purpose of using tiers is not to complicate things (although that may be an outcome) but rather to make a school finance system accomplish the myriad goals that state policy makers have.** That is, a foundation program can assure that all districts have sufficient funds to meet state requirements while making a uniform tax effort. A reward-for-effort system placed "on top of" the foundation program (a second tier) can provide some opportunity for districts to generate revenue above the foundation level.

One important rationale for combining a reward-for-effort system with a foundation program is to assure that districts have an equal opportunity to generate funds above the foundation level, particularly when it proves difficult to establish a foundation level. If policy makers cannot agree on a precise definition of the foundation level, the provision of aid to districts that want to spend above whatever foundation level is selected reduces the importance of setting the level exactly.

Tiered Funding Systems

If the parameters of such a system are properly set, the state can control its costs and provide a high level of equity across school districts. For example, a state might operate a foundation program that provides a revenue base of $2,500 per pupil with a specified tax effort of 25 mills in conjunction with a "kinked" reward-for-effort system that provides a guaranteed tax base of $90,000 for the first 10 mills above 25 mills and a guaranteed tax base of $75,000 for the next five mills (between 35 and 40 mills of total tax effort). Under such a system, a district with $50,000 of property wealth per pupil, making a tax effort of 36 mills, would generate $3,475 per pupil of revenue, receiving $1,675 per pupil in state aid and raising $1,800 per pupil in local tax revenue.

Another issue that should be considered when policy makers create a multi-tiered system is where authority will reside to impose taxes. Under most circumstances, it makes sense for school boards to have the authority to set property tax rates under a foundation program (although this is not required). However, under reward-for-effort systems, where the purpose is to increase flexibility, it is more appropriate that the voters be given a chance to vote on tax rates. Given the widely varying traditions of the states, no precise rules apply everywhere; however, it is one more issue that policy makers should consider in building a school finance system.

IV. Determining the Needs of School Districts

The foundation program and reward-for-effort systems are designed to make the allocation of state education support sensitive to the wealth of school districts. Like wealth, the needs of school districts are caused by factors beyond the control of districts that affect the cost of providing education services and vary across the districts. It makes sense to make the allocation of state aid sensitive to needs as well as wealth.

Programmatic Characteristics

Policy makers recognize that the cost of providing educational programs and services to some pupils is higher than for other pupils. This is primarily true because pupil-to-teacher ratios are lower, more specialists are required or equipment needs are greater. The programs most typically identified by states as requiring higher-than-average resources include special education, vocational education, compensatory education and bilingual education. In some states, programs offered at ceratin grade levels are expected to cost more; for example, programs offered in the 1st, 2nd or 3rd grade may cost more than those offered in the 4th, 5th or 6th grade.

More recently, states have begun to identify groups of pupils for whom special, high-cost services will be provided without knowing precisely what the cost of such services will be. For example, additional funds may be provided for "at-risk" pupils on a prospective basis rather than on a reimbursement basis, making it difficult to use the excess cost approach typically used in categorical programs. Three important policy questions that need to be answered in order to make state aid sensitive to programmatic cost differences are:

- Which one of the basic approaches will be used?
- How will pupils be categorized?
- What will the level of reimbursement be?

Which one of the basic approaches will be used?

The state can either (1) pay a specified amount for a particular service (and require that the funds be spent for that purpose) or reimburse districts for excess costs to provide a service (categorical programs); (2) pay a specified amount for a particular service or to serve a specified kind of pupil but not require that funds be spent on those services or pupils (block grant), or (3) weight pupils to reflect the relative cost of serving them and integrate the weighted pupil count into the basic system (foundation program or reward-for-effort system) used to provide equalized support (weighted pupil approach).

Categorical programs and block grants may be equalized (made sensitive to district wealth), but they typically are not. **The advantage of a categorical or block grant program is ease of calculation (the state assigns an amount or the accounting system defines excess expenditures).**

A pupil weighted approach builds in sensitivity to wealth as well as need, and weights can be assigned for any group of pupils. The disadvantages are that it takes some effort to develop weights that reflect true costs and there may be some incentive to misclassify pupils in order to obtain higher weights and corresponding state aid. (This is minimized by requirements for individual education plans and audits of pupil classification.)

Programmatic Characteristics

How will pupils be categorized?

Pupils may be classified in a variety of ways.

1. Pupils can be classified by physical condition, disability or participation in a specific program. This approach assumes that every program or every different disability is different and that costs can be assigned easily.

2. One can categorize pupils into distinct service delivery groups regardless of physical condition and assume that pupils with different physical conditions are treated in a similar way. That is, particularly as a result of mainstreaming, pupils are in a regular classroom and receive ancillary services, or pupils are in a regular classroom half time and in a small group situation half time, or pupils are in a special class all day.

3. Programs can be classified as being relatively high, medium or low cost with officials primarily concerned about large differences in program costs and unconcerned about small differences, particularly given a lack of precision in pupil count or program expenditure data.

One of the most perplexing problems that interferes with the development of good cost data for programs is a lack of precision in pupil count data. Since many pupils spend part of their day in one program and another part of the day in another program, it is necessary to use a full-time equivalent pupil count to develop accurate cost data. The cost of obtaining such information and linking it to accounting information can be considerable.

What will the level of reimbursement be?

The third question is raised in light of the way that states have developed their mechanisms to support special programs.

It is not unusual to find a situation in which the state pays, for example, 50% of the cost of "regular" education (that is, the state pays, in the aggregate, half of the cost of the foundation program), 80% of the excess costs of special education (using a categorical program) and 60% of the cost of vocational education. This probably reflects the incremental development of those programs and the availability of state support at the time particular programs were added. The fundamental question raised by this situation is the justification for a

state paying a different proportion of the cost of providing different kinds of services.

District Characteristics

A variety of district characteristics have been shown to affect the cost of providing educational services. Most of these are clearly beyond the ability of school districts to manipulate, but some are still open for further discussion.

Size or enrollment is one of the most important district characteristics affecting the cost of providing education services.

District Characteristics

Most people recognize that very small school districts have per-pupil costs that are higher than more moderate size districts. There is considerable debate about the optimum size of school districts, reflecting the conflicting results of the studies undertaken on this issue. Some studies have concluded that the relationship between size and per-pupil cost takes the shape of a backward "J", with costs being highest in the smallest districts, lowest in moderate size districts, and higher again in very large districts (although not as high as in the smallest districts).

A variety of approaches can be used to account for the impact of size.

1. The use of a classroom unit basis for allocating funds, rather than the pupil unit, can make the allocation of state aid sensitive to size.

2. School districts can be grouped into size categories, each of which can be given a distinct foundation level.

3. A size formula can be created that increases the foundation level for districts below a specified enrollment level. In some cases, it may make sense to apply such factors by school rather than district. In most cases where particular districts receive large amounts of state aid due to a size adjustment, it makes sense to distinguish between districts that are small by necessity (they have no control due to distance or geography) and those that are small by choice.

Associated with size is sparsity (or isolation), a factor that some states consider in distributing state aid. Whether sparsity affects education costs in a way that is different from size is unclear. Sparsity may affect transportation expenditures in this way. States that use a "linear density" transportation formula or that reimburse districts for actual expenditures already consider the impact of sparsity. In states that do not use either of those approaches in providing aid for transportation, it may be necessary to create a sparsity adjustment, at least as far as transportation expenditures are concerned.

Another factor that can affect the cost of operating school districts is declining enrollment. Most policy makers accept the fact that districts that face rapid decline in pupils cannot reduce expenditures in tandem with the loss of pupils (fixed costs remain constant and it may not be possible to lay off employees quickly). The most typical approach used to adjust state aid for declining enrollment is the use of

multi-year average pupil counts (or the use of prior year pupil counts). While this approach will, in fact, increase state aid, it is not clear whether the amount by which state aid increases is appropriate.

An alternative approach is the use of a declining enrollment "matrix" that considers both the magnitude of decline and when decline took place. State aid is reduced for small amounts of decline or for enrollment decreases that took place in the past.

Some policy makers support the use of teacher training and experience (T&E) factors in the allocation of state aid.

The purpose of a T&E adjustment is to provide more aid to districts that have high concentrations of teachers with greater training and experience, the bases on which most teachers are reimbursed. One problem with a T&E (teacher training and experience) factor is that it rewards districts that are able to obtain teachers with more training and experience; to the extent that such districts are relatively wealthy, state aid may be disequalizing. Another problem is that under most circumstances, districts have flexibility in hiring and higher concentrations of experienced teachers may reflect district desire or ability to attract highly qualified people.

The one situation that may change this is sustained enrollment decline, particularly if districts must lay off the most recently hired personnel. Under these circumstances, policy makers should be sure they do not use two factors to address one problem; that is, it may not be necessary to have both a declining enrollment factor and a T&E factor.

One factor that has proved difficult to quantify is geographic cost-of-education. Policy makers recognize the effect location has on the cost of providing education services. This factor is designed to recognize that the cost of purchasing a similar quantity of resources, of similar quality, differs in different parts of a state. Only a few states have developed such a factor, which tends to be specified in terms of regional cost-of-living differences. States that have created factors other than cost-of-living adjustments have faced methodological difficulties, lack of data and results that apply only to a portion of all expenditures.

V. Determining the Fiscal Capacity of School Districts

Throughout the examples, the assumption has been made that relative wealth of school districts is defined in terms of property wealth. For the most part, states use property wealth, often in per-pupil terms, to indicate districts' fiscal capacity. This is the case because, in most states, the primary source of local revenue for schools is the property tax. The exception is in "dependent" school districts where the education budget is part of a general budget and revenue is obtained from a variety of taxes, including local property, sales and income taxes. However, policy makers have recognized for a long time that other factors may influence the relative fiscal capacity of school districts, not the least of which is the personal income level of the district.

District Fiscal Capacity

In some states, school districts derive substantial revenue from a tax other than the property tax, although there is no consideration of the other tax base in determining districts' fiscal capacity. In these cases, it makes sense to recognize the contribution of all tax bases on which local revenue for education is based in determining fiscal capacity.

One way to do this is to use the Representative Tax System approach, created by the Advisory Commission on Intergovernmental Relations, and to include those tax bases commonly used, or at least available to, all school districts.

Some states rebate to school districts a portion of the amount collected by a particular state tax, usually the income tax. In this situation, where school districts are obtaining revenue from a tax other than the property tax, it also makes sense to consider the tax base from which such funds are obtained in determining the wealth of school districts. This can be done most simply by counting the revenue obtained as a deductible under either the foundation program or the reward-for-effort system since the same income tax rates are used throughout the state.

States use a variety of ways to combine income and property wealth. In some cases, property wealth and income wealth are added together. In other cases, they may be weighted before being combined. Others may adjust property wealth by an income factor, such as the ratio of median family income in a school district to the median family income of the state. In one case, a state determines the average property tax effort required to produce all local revenue expected under the foundation program, calculates the income tax effort that would be needed to raise the same amount, then applies one half of each rate (property and income) toward the tax bases of each school district to determine each district's contribution to the foundation program. This is done even though no district actually uses an income tax to raise local revenue for schools.

Income Factors

The problems of using income factors include:

- **Identification of an income measure** (median family, per capita, personal disposable and so on)
- **Acquisition of income data** on a school district basis
- **Merging of residential property and commercial/industrial property** with only personal income data (which excludes corporate income)
- The fact that **some people do not file income tax returns.**

Policy makers must be careful in creating income factors. In some states, property taxes are reduced through the use of homestead exemptions or circuit breaker mechanisms. Such mechanisms are much more precise, as far as an individual taxpayer is concerned, than the use of factors that apply to all residents of a school district (as is the case when property wealth is multiplied by a median family income ratio). It is important to consider the full impact of the tax system before creating an income adjustment.

VI. Other Structural Issues

Policy makers need to consider a variety of other issues as they examine their school finance systems. These issues include, but are not limited to, tax or expenditure limits, fiscal incentives, transportation and teacher retirement programs.

Tax or Expenditure Limits

One of the most important functions of a school finance system is to control the taxing and spending behavior of school districts. In part, such controls are used to regulate tax burdens, particularly in light of the public's well-known distaste for property taxes. In part, such controls are used to manage the disparity in tax rates and revenues across school districts.

Tax or Expenditure Limits

States use a variety of methods to control the taxing and spending behavior of school districts.

- Some have constitutional limits on property taxes, which, in conjunction with low assessment practices, may shift the burden of paying for education to the state (which it may or may not be able to accept).
- Some states set statutory limits on property tax rates, growth in property tax rates or property tax revenue or restrictions on school district budgets or year-to-year increases in budgets.
- A few states put absolute restrictions (caps) on the extent to which school districts may spend above foundation program levels, regardless of local willingness to impose higher taxes.
- In some states, the approaches are more esoteric, restricting increases in property values or the portion of any increase that can be taxed, permitting voter recall of school boards if expenditure increases exceed specified levels or exempting property from taxation.

States use a variety of policy issues connected with controlling the tax and spending behavior of school districts. Policy makers should consider these issues before they implement something primarily for political purposes:

- The overall adequacy of funding for education
- Districts with different characteristics (high spending versus low spending, high property wealth versus low property wealth, high tax rate versus low tax rate districts and so on);
- Pupil or taxpayer equity
- The distribution of state aid to districts
- The state's ability to generate funds for education.

Fiscal Incentives

To many state policy makers, a school finance system is nothing more than a way to reimburse school districts for spending decisions they have already made and that may, or may not, have been very effective. More and more policy makers would like to see school finance systems either reward districts for taking steps to improve themselves (i.e., by restructuring) or for producing results (i.e., pupil achievement). **While it is difficult to conceive of an entire school finance system built in that fashion, it is not inappropriate to distribute some funds in a way that provides incentives for districts to behave in a particular way.** Some questions that would need to be answered are:

Fiscal Incentives

- What is meant by restructuring?
- How should pupil performance be measured?
- Is it equitable to provide funding solely on the basis of pupil achievement? In fact, foundation programs and reward-for-effort systems already provide incentives for fiscal behavior.

Some states do provide fiscal incentives for schools to behave in particular ways. For example, some states provide funds to districts that share administrators, create parent councils, offer more classes or do other things legislators feel contribute to more effective operation. Some states even provide funds based on the performance of pupils. Typically such funds are a small proportion of all state aid and are not equalized; that is, wealth is not considered in the distribution.

If policy makers choose to move in this direction, they will need to think carefully about the specific objectives of education programs, the best way to organize such programs and how to determine whether objectives are being achieved. The day is coming when progress in answering these questions will justify allocating some state aid to encourage districts, schools and teachers to demonstrate that they are performing at high levels.

Transportation

In paying for transportation it is important that a state: (1) have an objective measure of cost, (2) equalize the distribution of funds on the basis of district wealth and (3) pay a share of total costs that is consistent with the share paid for other services.

Transportation

Most states pay a significant portion of transportation costs, often providing a larger share of such costs than is provided in support of other education services. States tend either to reimburse districts for a fixed proportion of eligible expenditures (excluding the costs associated with providing door-to-door service or field trips) or to provide funds on the basis of a formula that considers the number of

pupils transported, the number of miles traveled, linear density or some other reasonably objective measures of the task districts face in moving pupils. In some cases, transportation costs are included in foundation program costs, assuring that the state is sensitive to district wealth.

Teacher Retirement Programs

Teacher Retirement

In most states, the state has the major responsibility for funding the teacher retirement program. In others, the full burden of teacher retirement falls on school districts, while in still others, the state may pay the bulk of the cost but leave school districts responsible for portions incurred either when salary levels exceed a specified point or when more people are employed than are eligible to be reimbursed by the state. Where states pay the full cost of retirement programs (and social security), the system behaves in part like a flat grant. Wealthy districts and poor districts receive the same amount of state aid if they employ the same number of people and pay them at the same level. Because districts with the greatest needs, and hence more teachers, receive more state aid, this acts in part like a categorical program. But more state aid may be allocated to wealthy districts to the extent that they employ more people and pay them at higher levels (disequalizing).

One solution to this problem is to equalize retirement programs so that all districts pay a portion of the cost and wealthy districts pay a higher proportion than poor districts. One way to accomplish this is by moving retirement costs into the foundation program. As long as districts make the contributions specified by the state retirement system, there is no reason to think that such an approach threatens the integrity or fiscal viability of the retirement program.

Conclusion

The purpose of this document has not been to describe a single structure for a school finance system. There is no reason to believe that one state's school finance system would work particularly well in another state. The fact is, there is no "best" school finance system. A good system is one that achieves the goals policy makers establish for it. The work in building a school finance system is in specifying its goals and making sure they are being accomplished.

One of the most common complaints about school finance systems is that they are too complex. Given the multiple goals that every state's school finance system is trying to achieve and the large number of districts such systems must consider, it is not unexpected that they would be somewhat complicated. The intricacy of school finance formulas is both a blessing and a curse—a blessing because it allows policy makers to choose among alternative structures; a curse because it reduces the likelihood that many policy makers will feel entirely comfortable with the formulas that allocate billions of state dollars.

As any policy maker who has tried knows, school finance systems are difficult to change. On the other hand, they are hard to leave alone. But tinkering around the edges of a school finance system will not suffice. Even under the best of conditions, the changing environment in which any system works will create new challenges for the system. Under the worst, major revisions are a necessity.

In order to build an effective school finance system, it is necessary to specify the goals and objectives that system should achieve. Although a school finance system is likely to be complex, complexity can and should be justified. Finally, it is necessary to evaluate the system from time to time to be sure it is working properly.

GLOSSARY

ADA: Average daily attendance; WADA is weighted ADA.

ADM: Average daily membership; WADM is weighted ADM.

AFDC: Aid to Families with Dependent Children.

AGI: Adjusted Gross Income.

Assessed Valuation: The value of a taxable property as determined by a government agency or tax assessor. Taxes are paid on the basis of a property's assessed valuation. The assessed valuation of property in most states and localities is usually less than the market value of the property.

Assessment ratio: The ratio of actual assessed valuation to market valuation.

Bonded Indebtedness: Most states limit the ability of local governments, including school districts, to incur debt. Limits on debt associated with the sale of bonds, bonded indebtedness, are frequently tied to the source of revenue from which the debt is to be repaid. In the case of school districts, this usually is the assessed valuation of property. Bonded indebtedness can be linked to local tax rates. When a state fully funds the activities for which debt is normally obtained, there may be no local provisions for incurring or limited debt.

Categorical Aids: State or federal aid designated for a specific use. Examples are transportation aid, special education aid, aid for vocational education and aid for capital construction.

District Power Equalization (DPE): Refers to a state equalization aid program that "equalizes" the ability of each school district to raise dollars for education. In a pure DPE program, the state guarantees to both property-poor and property-rich school districts the same dollar yield for the same property tax rate. In essence, equal tax rates produce equal per pupil expenditures. DPE programs are given different names in different states, including Guaranteed Tax Base Programs (GTB), Guaranteed Yield Programs (GTY) and Percentage Equalization Programs (PE). Each focuses on local ability to generate revenue for schools.

Equalization: The process of compensating for differences in order to make equal. Several related concepts are useful. **Capacity Equalization** is the process of compensating for differences in school districts' ability to support education in order to achieve student equity and taxpayer equity. **Service and programmatic equalization** is the process of compensating for differences in the level of services or programs in a school or school district in order to achieve student equity.

Foundation Program: A state equalization aid program that typically guarantees a certain foundation level of expenditure for each student, together with a minimum tax rate that each school district must levy for education purposes. The difference between what a local school district raises at the minimum tax rate and the foundation expenditure is made up in state aid.

Foundation or Guarantee Level:	That level of per pupil expenditures guaranteed to all school districts in a state through a combination of state aid and locally raised revenue.
Fiscal Capacity:	The total economic resources available to a government for tax purposes. In school finance, fiscal capacity is generally defined as property valuation per pupil, but several states include income or other measures of wealth with property valuation as a measure of fiscal capacity.
Fiscally Dependent/ Independent School Districts:	School district budget and tax rate procedures vary among the states. Often, local school boards have authority for both developing budgets and levying taxes to support such budgets. These powers are referred to as fiscal independence. In some instances, school boards do not possess independent tax authority. Upon developing a budget, the board must submit it to another governmental entity, typically a municipal or county governing body for approval. When these jurisdictions maintain appropriating authority, the school district is considered fiscally dependent.
FTE:	Full-Time Equivalent count of students determined by computing the pupil minutes of time in each program for the school year and dividing by the total number of minutes in the school year.
FY:	Fiscal year. A 12-month period with a starting date selected by the state and used as the period to be covered by the budget.
General Aid:	State or federal aid which can be used by a school district for any purpose.
Guaranteed Tax Base (GTB):	See District Power Equalization.
Guaranteed Yield Program (GTY):	See District Power Equalization.
Impact Aid:	A program that provides assistance to school districts that serve significant numbers of children whose parents either work for the federal government or reside on property owned by the federal government.
Instructional Unit:	In contrast to pupils as the base (unit) for quantifying district needs and allocating funds, some states allocate funds on the basis of the number of pupils per classroom or per teacher. These instructional units can be computed for specific program areas, grade levels or types of school districts (i.e., urban, rural).
Local Leeway:	In state aid programs, the right of a participating district to tax itself at a rate above the mandated local tax effort or spend above a specified level of expenditure.
Mill:	A millage rate is the amount of property tax dollars levied for each $1,000 of assessed valuation.
Percentage Equalization Program:	See District Power Equalization.

Property Tax Circuit Breaker Program: A tax relief program, usually financed by the state, that focuses property tax relief on particular households presumed to be overburdened by property taxes. It is intended to reduce the presumed regressivity of the property tax. A typical circuit breaker program attempts to limit the property tax burden to a percent of household income and applies only to residential property taxes (a few states do apply such relief to agricultural property). The percent usually rises as income rises in an attempt to make the overall burden progressive. Most states enacted circuit breaker program initially just for senior citizens, but some have extended relief to all low-income households, regardless of age.

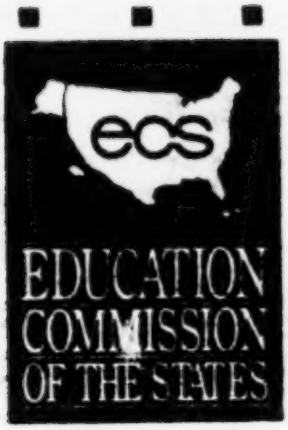
Pupil Count: The method of counting students served by the public schools. Several methods are frequently used. **Average Daily Attendance** is the actual presence of enrolled students counted at two or more times during the school year and averaged over the number of counts. **Average Daily Membership** is the number of students enrolled, counted at two or more times during the school year and averaged over the number of counts. **Full-Time Equivalent (FTE)** pupils is a count reflecting the amount of time a student spends in particular instructional programs or services. For instance, a student might spend 50% of his/her time in a program for exceptional students and the remaining 50% in a regular instructional program. The FTE count would be 1.00.

Pupil-Weighted System: A state aid system in which pupils are given different weights based on the estimated or assumed costs of their education programs. Aid is allocated on the basis of the total number of weighted students. Usually, the cost of the education program for grades 4-6 is considered the standard program and weighted 1.0. States using this approach might decide to invest more heavily in the early grades, in effect "weighting" these students more heavily (typically around 1.30). High school students might also receive more weight (typically 1.25). The major education program areas where weights are frequently used are special education and vocational education. The weights depend on the number of categories of students or services defined.

Recapture: A feature in state aid to education formulas where local districts which raise an amount per pupil in excess of the state guaranteed expenditure per pupil would have to pay back the excess to the state for redistribution to poorer schools (i.e., those with less valuation per pupil).

Required Local Tax Rate: A term indicating the mandated property tax rate required for participation in the state aid system. The required local tax rate is usually associated with a foundation program and is often expressed in terms of **mills**. A millage rate is the amount of property tax dollars to be paid for each $1,000 of assessed valuation.

Required Local Effort (RLE): A local tax that must be levied. Local funds raised by the RLE are subtracted from the total foundation funds to determine the amount of state aid the district receives.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